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C O N F I D E N T I A L SECTION 01 OF 02 HONG KONG 001984

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TREASURY FOR U/S MCCORMICK, A/S LOWERY, DAS DOHNER AND
OASIA;
STATE FOR EAP/CM, EEB/IFD/OMA; NSC FOR WILDER AND TONG

E.O. 12958: DECL: 10/24/2028

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SUBJECT: HONG KONG MONETARY AUTHORITY CHIEF SEEKS TO BOOST
CONFIDENCE

REF: HONG KONG 1909

Classified By: Consul General Joseph Donovan, Reason 1.4 b/d

¶1. (C) Summary: Hong Kong Monetary Authority (HKMA) Chief Executive Joseph Yam told U.S. Treasury Undersecretary David McCormick October 23 that Hong Kong's banking system is sound and that recent HKMA measures are designed to boost investor and depositor confidence rather than address structural weaknesses. He noted that Singapore authorities felt they had been forced to follow Hong Kong's move to temporarily guarantee 100 percent of bank deposits. Yam said he had offered to coordinate more closely with regional economies when the bank deposit guarantee is lifted. End Summary.

¶2. (U) U.S. Treasury Undersecretary for International Affairs David McCormick met Hong Kong Monetary Authority (HKMA) Chief Executive Joseph Yam on Wednesday, October 23 to discuss global financial turbulence and steps the U.S. and Hong Kong have recently taken to address liquidity concerns and boost investor confidence in the banking system.

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HKMA Actions Designed to Boost Confidence

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¶3. (C) Yam began by thanking U/S McCormick for the regular communication between the Treasury and the HKMA as the U.S. has taken various measures over the past several months. The situation in Hong Kong is improving, although the Hong Kong stock market remains down, said Yam. He noted the recent HKMA announcement that the Hong Kong Exchange Fund would be used to guarantee 100% of deposits in the banking system until 2010 and would also be available to provide capital to banks as needed. (REFTEL) In fact, there is no immediate demand for capital in the banking system, but the HKMA needed to show they had the tools to pre-empt any crisis, said Yam. Because the Exchange Fund is under the direct control of the HKMA, there was no need for additional legislation, enabling them to act quickly.

¶4. (C) Unlike Singapore's Monetary Authority, the HKMA purposefully did not announce a limit to the pool of capital available to inject into the banks, in order to encourage greater confidence in the Hong Kong measures, Yam said. The HKMA issued the announcement believing that no Hong Kong bank would require capital injections, but as the economy deteriorates, Yam predicted that one or more institutions would need help in the next two years. The terms for Exchange Fund capital have not been published. Different banks will require different treatment, said Yam, but there will definitely be strings attached. He offered that HKMA

had thought of amending capital requirements to give senior status to HKMA-provided capital, but finally chose not to do so since it would take Hong Kong out of compliance with the Basel Accords.

14. (C) HKMA has also been injecting liquidity into the market and has stepped forward to provide US dollar liquidity to foreign banks when local banks have been unwilling to do so. The figure is not significant, said Yam, just over US\$ 1.2 billion. More significant is HKMA's willingness to accept a wide variety of capital, including Treasuries, mortgages, and rated commercial paper as collateral.

15. (C) U/S McCormick explained the U.S. plan to recapitalize domestic banks, beginning with the big nine that control 50 percent of U.S. banking system assets, the proposal to directly purchase whole loans, and plans for mortgage-backed securities auctions. The credit markets are improving, said McCormick, but the U.S. equity markets are responding more slowly. Yam offered that the same was true in Hong Kong. He noted that the announcement that morning that CITIC Pacific, one of the largest Chinese-controlled enterprises in Hong Kong, had been forced to write off US\$ 2 billion in soured foreign currency derivatives will shake Hong Kong investor confidence.

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Global Financial Discussions Should Include Hong Kong

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16. (C) Chief Executive Yam asked McCormick for his reaction to suggestions that the world needs a new global financial

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architecture. The U/S replied that the United States would shortly announce a series of meetings to address the issue. Some in Europe are strongly advocating significant changes, he said, but the U.S. believes the first meeting should focus on objectives, rather than proposals. While it is not clear who will be invited to attend, said McCormick, it should include emerging market economies and the IMF. He noted that the Financial Stability Forum has played a very positive role and that Hong Kong is a valuable member of that Forum.

17. (C) Yam offered that his office would like to contribute to the discussion on the important issues at stake, noting that Hong Kong participates fully in the WTO, APEC, and other bodies. If attendance at the summit is restricted to G-20 countries, would Hong Kong be able to participate as part of the Chinese delegation, asked McCormick? Yam replied that it would be difficult unless someone outside of Hong Kong raised it with Beijing.

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Chinese Distracted, Won't Take Proactive Role

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18. (C) Yam told McCormick that financial services liberalization in China will be much more difficult in the future. While China has been a responsible partner, it has not been proactive or particularly constructive in its response to the crisis, said McCormick. The Chinese authorities have been more conservative; shortening the maturity of their dollar asset purchases and pulling back from lending to foreigners. Yam replied that the mainland economy has been relatively immune from the financial aspect of the crisis thus far and Beijing has been distracted by food safety and other issues.

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Boosting HK Confidence, Angering Singapore

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19. (C) Yam agreed with the U.S. decision to inject capital into large U.S. banks, saying that capital is key to resolving the confidence crisis. He asked if US\$ 700 billion

would be enough, given the flow of questionable assets. Yam noted that the run on Bank of East Asia was the result of rumors about BEA's exposure to Lehman Bros., products. These internet rumors, unless quickly quashed, could spark a contagious confidence crisis. The HKMA's decision to announce temporary blanket insurance for Hong Kong depositors was an important part of the response to boost confidence.

¶10. (C) The Monetary Authority of Singapore (MAS) was upset by the HKMA announcement and felt they had been forced to offer a similar blanket guarantee, said Yam. He tried to contact them ahead of time but was unable to do so, he said. He has since had additional discussions with his MAS counterpart and they have agreed to coordinate the lifting of their respective deposit insurance schemes in 2010.
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